111 Market Place
Suite 500
Baltimore, Maryland 21202

January 9, 2005

Ms. Mary Cottrell, Secretary
Department of Telecommunications and Energy
One South Station
Boston, MA 02110

RE: D.T.E. 04-115, Request for Comments on the Procurement of Default Service Power Supply for Residential and Small Commercial and Industrial Customers.

Dear Ms. Cottrell:

Pursuant to the Department of Telecommunications and Energy's ("Department") December 6, 2004 request for comments in the above mentioned proceeding, enclosed please find an original plus ten (10) copies the Comments of Constellation NewEnergy, Inc. and Constellation Energy Commodities Group, Inc. (collectively, "Constellation"). In addition please find an electronic copy of this filing on diskette. Kindly date stamp and return one (1) copy in the self-address stamped envelope.

Please do not hesitate to call me if you have any questions.

Sincerely,

Lisa M. Decker/EAK

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Commonwealth of Massachusetts
Department of Telecommunications and Energy

Request for Comments on the Procurement of Default Service Power Supply for Residential and Small Commercial and Industrial Customers	)	D.T.E. 04-115

Comments of
Constellation NewEnergy, Inc. and
Constellation Energy Commodities Group, Inc.

I. INTRODUCTION

Constellation Energy Commodities Group, Inc. ("CCG") and Constellation NewEnergy, Inc. ("CNE") (collectively, "Constellation") are pleased to submit the following comments to the Department of Telecommunications and Energy (the "Department") in response to the Department's Request for Comments dated December 6, 2004 in the above captioned docket.

CCG is a wholesale supplier of electric power to many of New England's electric utilities in connection with either their standard offer or default service obligations. CCG is a regular participant in Default Service power supply solicitations in Massachusetts and is from time to time a successful bidder.

CNE is the leading competitive retail supplier of electricity in the United States and is a licensed electric retail supplier in 14 states, including Massachusetts, and two Canadian provinces. CNE currently provides over 10,000 megawatts ("MW") of electric supply directly to businesses throughout the country for their own use.

CNE and CCG are subsidiaries of Constellation Energy Group, Inc., a Fortune 300 company headquartered in Baltimore, Maryland which also owns Baltimore Gas and Electric Company, a regulated utility.

The following comments are directed to the questions posed by the Department in its Request for Comments dated December 6, 2004. They do not address the Default Service procurement policy for larger commercial and industrial customers nor do they seek to address any other issues beyond the scope of the five questions posed by the Department. Should the Department desire additional input regarding these issues, Constellation would be pleased to meet with the Department individually or to participate in a technical conference or public hearing on the matter.

1. **Would smaller customers be better served if power supply for default service is procured using a portfolio of more than two solicitations? Please discuss the advantages and disadvantages of increasing the number of solicitations used to procure default service supply.**

The advantage of procuring supply through semi-annual solicitations for 50% of the default service requirement is that this produces a diversity of forward contracts entered into at different times. Forward contract markets change from time to time as changes in fuel prices, spot electricity prices or wholesale market rules become reflected in the forward electric market. Blending forward supply contracts with different "vintages" introduces timing diversity into the procurement process and tempers the effect of market conditions that may exist during any

one procurement cycle. This tempering effect can help to ease potential rate shock if forward markets are sharply upwards at the time of any procurement.

The downside of blended solicitations is increased transaction costs, increased costs of contract administration and the need for more frequent rate adjustments. Blending contracts of varying and longer terms can also create greater divergence between default service rates and market prices, as the supply portfolio will always contain much older vintage contracts, less reflective of current market conditions. This may have an adverse effect on retail competition as a result.

In light of the pros and cons we believe the best approach is a balanced one, somewhere in the neighborhood of two or three overlapping solicitations with terms varying from 6 to 36 months. The Department's current Default Service procurement regulations are currently well within this range. Since parties are already familiar with the current process we do not see any clear advantage at this time to promulgating any changes to that process for small volume customers.

2. **Would smaller customers be better served if power supply for default service was procured for a term longer than twelve months? Please discuss the advantages and disadvantages of using supply terms greater than twelve months. In particular, please discuss:**

    a. **whether longer contract terms are likely to produce lower prices,**
    b. **how such an approach would affect price certainty and market efficiency, and**
    c. **how such an approach could be tailored to accommodate customer migration to competitive supply.**

Longer contract terms are not likely to produce lower prices. At the present time there is ample market liquidity and price transparency in the New England Power Pool ("NEPOOL") wholesale power market for supply contracts with terms of 12 months. Markets are somewhat less liquid and transparent for products with terms between 12 and 36 months. Beyond three years, however, there is even less liquidity and thus contracting becomes more difficult, i.e, the costs to hedge future obligations increases as the contract length increases, especially where supply is not tied to a single power plant. In addition to increased hedging costs associated with long-dated contracts, there is an ongoing level of regulatory uncertainty caused by the evolving changes to NEPOOL market rules at the wholesale level and to the ongoing restructuring of retail market rules at the state level. Ongoing review of competitive wholesale and retail market rules is a necessity in developing competitive markets, but the level of regulatory uncertainty that it creates does have an upward effect on default supply bids when those bids are required far in advance of the service obligations, as bidders charge a premium to their offers in order to cover the increased risk presented by the uncertainty. Therefore, we do not believe contract terms of more than three years will produce lower prices.

Longer contract terms would, however, achieve greater price certainty for default service customers and would have a positive effect in promoting increased liquidity and transparency in the longer term forward markets. These

benefits, however, must be balanced against the cost premiums that forward contracts create, as noted above.

Accommodation of customer migration to competitive supply is already facilitated through the use of requirements contracts for default service supply, as opposed to contracts for fixed quantities of electricity. These contracts avoid the potential for any new "stranded costs" when customers depart, because the wholesale supplier has agreed to manage all aspects of customer load changes.

Customer migration to competitive supply, however, is most likely to occur when prevailing market prices are at or below default service rates. Default service serves as a temporary protection for customers when prices move up and retail choice serves as an attractive option for customers when prices fall. With longer term supply procurements there may be a greater opportunity for customers in a falling market but there will be a greater inhibition toward retail migration if market prices are rising. In other words, if the goal is to promote retail migration then longer term procurements are a riskier strategy. If market opportunities are foreclosed for too long retailers may exit the market and may not be quick to return when default service prices are eventually adjusted closer to prevailing market. Finally, shorter contract terms help to preserve the principle that customer rates should reflect current market prices.

Customer migration to competitive supply has been successful in the medium and large commercial and industrial classes, evidenced by robust switching rates. Offering choice of supplier to residential and small commercial customers

has proven more difficult as the acquisition costs are often greater than what a competitive supplier can bear. Nevertheless, it is important to note that residential and small commercial customers have benefited and will continue to benefit from lower rates obtained via Massachusetts' competitive wholesale supply procurement process. In addition, as was the experience in telephony, migration to competitive supply for small customers may take additional time. As the competitive supply industry matures and the lower hanging fruit has been consumed, it is reasonable to assume that suppliers will seek to expand their markets by finding ways to offer choice to smaller customers. Therefore, we suggest that the Department continue on its current path.

3. **Would smaller customers be better served if power supply for default service was procured on a statewide basis? Please discuss the advantages and disadvantages of using a statewide approach to default service procurement.**

As the Department notes, statewide procurements have been successfully used recently in Maine[1], Maryland and New Jersey. Constellation has successfully participated in these statewide solicitations and we support their continued use. At the same time, however, we have also participated in the individual utility solicitations conducted in Massachusetts and Pennsylvania and our experience with these solicitations has been equally satisfying. Both have attracted strong interest and participation from qualified bidders, have produced

[1] Although the ME PUC procures power for customers of Bangor Hydroelectric Company and Central Maine Power Company at the same time it solicits separate bids, establishes separate rates and uses slightly different supply contracts for each service territory. In our view, therefore, the Maine process is more akin to the current process in Massachusetts than the statewide auctions in MD and NJ.

competitive prices and have been free from bias or confusion. While we have no reason to discourage a statewide solicitation should the Department choose to use such a process we do not see any advantage in expending the time and effort to move from the current approach to a statewide solicitation. In short, both approaches work and produce similar results, therefore the need for change is simply not compelling.

4. **Would smaller customers be better served if power supply for default service was procured using an auction process (e.g., descending clock) rather than through requests for proposals? Please discuss the advantages and disadvantages of using an auction process to procure default service. In particular, please discuss whether using an auction is likely to produce lower default service prices.**

Both the RFP solicitation process and the use of an auction process will produce competitive supply offers that reflect the cost of supply, including compensation for the attendant risks of requirements service. As with the prior question, we see no particular advantage in moving from the current RFP system to an auction process that would support the time and effort necessary to make the change.

5. **Although the term "default service" is statutory, G.L. 164, § 1, it has confused some customers because of its unintended suggestion of nonfeasance in performing a legal or contractual obligation. Is there some better or more descriptive term that ought to be used by the distribution companies on and after March 2005?**

Constellation suggests that the term "default service" is appropriate as it denotes that if a customer does not choose a competitive supplier, the customer "defaults to" the utility service. In addition, changing the term default service,

after seven years in the utility lexicon, would likely result in customer confusion. It has been suggested that the term "basic service" would be a better term. However, the term basic service would have the unfortunate effect of implying that the utility service was, by its nature, less expensive than service from a competitive supplier. That impression would often be untrue and would likely inhibit migration to competitive supply. If the Department decides to change the term, one alternative might be "provider of last resort." This is a descriptive term that simply states that if a customer does not choose a competitive supplier, the utility becomes the provider of last resort.

Conclusion

In conclusion we believe the Department has already struck an appropriate balance between competing considerations and that while many of the modifications suggested in the Request for Comments would produce an equally acceptable process, none of the suggested modifications is likely to produce an improvement over the existing procurement process. Our recommendation therefore is to continue the current process for now and to re-evaluate its success and the need for change, if any, sometime in the future.

Respectfully submitted,

CONSTELLATION ENERGY COMMODITIES GROUP, INC.

By

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Dated: January 9, 2005

CONSTELLATION NEWENERGY, INC.

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Dated: January 9, 2005